



## MOVING INTO THE NEW MILLENNIUM

THE CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

OPERATIONS SUMMARY YEAR ENDED JUNE 30, 1999

## PROFILE

The California Public Employees' Retirement System (CalPERS) is the nation's largest public pension fund and the third largest in the world, with assets at June 30, 1999 of approximately \$159.4 billion.

Headquartered in Sacramento, CalPERS provides retirement and health benefit services to more than 1.1 million people and more than 2,400 public employers. The System also operates eight regional offices located in San Francisco, Los Angeles, Orange County, Sacramento, San Bernardino, San Diego, Mountain View, and Fresno.

CalPERS is led by a 13-member Board of Administration, consisting of member-elected, appointed, and ex officio members.

Our membership consists of 816,512 active and inactive members from the State, school districts, and local public agencies, and 343,341 retirees, beneficiaries, and survivors.

Established by legislation in 1931, the System became operational in 1932 for State employees only. In 1939, other public agencies were allowed to contract with CalPERS to provide retirement benefits for their employees. We began administering health benefits to State employees in 1962 under the Public Employees' Medical and Hospital Care Act. Local public agencies joined in our health program on a contract basis five years later.

**The California Public Employees' Retirement System**

**COMPREHENSIVE ANNUAL FINANCIAL REPORT  
OPERATIONS SUMMARY**

**Year Ended June 30, 1999**

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## FINANCIAL HIGHLIGHTS

### PUBLIC EMPLOYEES' RETIREMENT FUND (UNAUDITED)<sup>1</sup>

*(Dollars in Thousands)*

	1999	1998
<b>Assets</b>		
Cash & Cash Equivalents	\$7,265	\$6,104
Investments, at Fair Value	169,811,965	154,433,280
Receivables	2,228,945	1,895,274
Other Assets	74,749	71,896
<b>Total Assets</b>	<b>\$172,122,924</b>	<b>\$156,406,554</b>
<b>Liabilities</b>	<b>\$12,765,139</b>	<b>\$12,708,595</b>
<b>Net Assets Held in Trust for Pension Benefits</b>	<b>\$159,357,785</b>	<b>\$143,697,959</b>

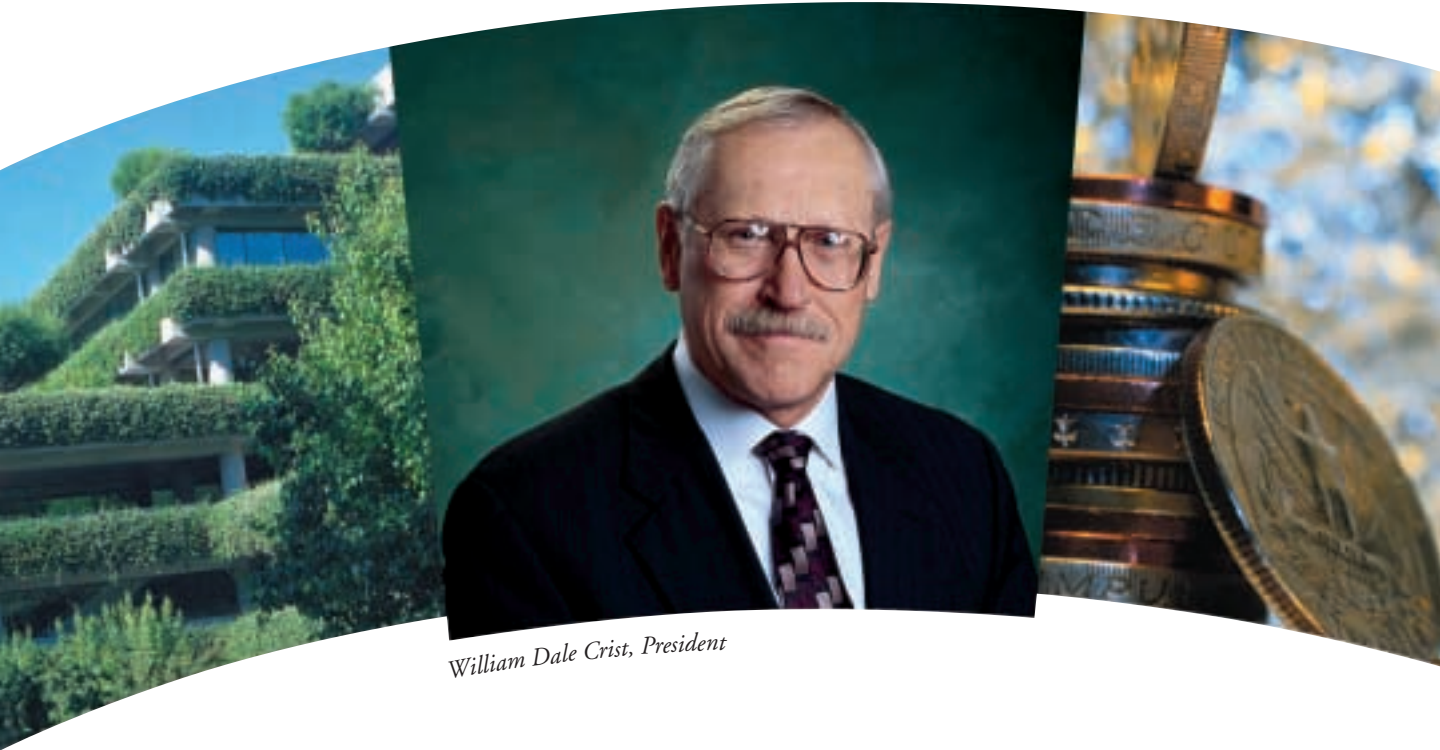
### ADDITIONS & DEDUCTIONS

	1999	1998
<b>Additions</b>		
Member Contributions	\$1,522,507	\$1,443,233
Employer Contributions	1,598,317	2,289,526
Investments Income	17,621,490	23,515,372
Other	1,036	3,532
<b>Total Additions</b>	<b>\$20,743,350</b>	<b>\$27,251,663</b>
<b>Deductions</b>		
Retirement, Death & Survivor Benefits	\$4,776,869	\$4,425,923
Refunds	160,841	160,965
Administrative Costs	145,814	128,584
<b>Total Deductions</b>	<b>\$5,083,524</b>	<b>\$4,715,472</b>
<b>Increase in Net Assets Held in Trust for Pension Benefits</b>	<b>\$15,659,826</b>	<b>\$22,536,191</b>

Complete financial information of all the Funds administered by CalPERS can be found in the Comprehensive Annual Financial Report for the year ended June 30, 1999.

**Note:**

<sup>1</sup> Differences in the amount shown for investment assets in these Financial Highlights and the Investment Portfolio amount reported in the Investments Section of this summary are due to differences in reporting methods. In accordance with GASB Statement No. 28, financial statements include Securities Lending Collateral. Also, Net Investment Receivables/Payables are not included here.



*William Dale Crist, President*

## PRESIDENT'S MESSAGE

### TO THE CalPERS FAMILY:

On behalf of the CalPERS Board of Administration, I am pleased to present the CalPERS Operations Summary and Comprehensive Annual Financial Report for June 30, 1999 — our last of this century.

As we close this final fiscal year of the 20<sup>th</sup> century, I am extremely proud to report a year of strong growth, improved service, continued financial security, and a sound health benefits program. Here are just a few of the highlights:

- As of June 30, 1999 the market value of the Fund stood at \$159.4 billion — \$16.1 billion more than the previous year, with a 12.5 percent rate of return.
- Another strong year of investment returns helped bring to a successful conclusion a CalPERS Board of Administration initiative to reduce benefit inequities among members, some of which had existed for almost 30 years.
- Fiscal year 1998-99 laid the foundation for enhanced retirement formulas, First Tier availability for new State hires, and ad hoc benefit increases for retirees.
- Using improved automation, we strengthened our customer service delivery capabilities. We began simplifying our benefit processes, expanded our ability to conduct business through the Internet, and developed strategic approaches that will make our customer service functions faster with continued reliability.

The next century will require even more skill and determination. Our goal is to be a top-flight organization in every way. We will emphasize customer service and sensitivity, providing enhanced service options, and delivering efficient and effective service to all who rely on us. Our investment in technology to help streamline our business processes will continue, and we will set service level benchmarks and measure our performance against them — leading the pension and health benefits industry.

CalPERS is dedicated to staying focused on the latest retirement plan and policy designs. By monitoring trends and staying close to all members of the CalPERS family, we intend to meet the changing needs of employers, employees, and retirees alike, moving together into the future.

Respectfully submitted,



William Dale Crist  
President  
CalPERS Board of Administration



*CalPERS Board of Administration from left to right: Rob Feckner, Robert F. Carlson, Joseph A. Thomas, Jennifer Ducray-Morrill, William Rosenberg, Marty Morgenstern,*

## CALPERS BOARD OF ADMINISTRATION

**WILLIAM DALE CRIST**  
 President  
 Employee Member  
 (elected by State members)  
 Professor, CSU—Stanislaus  
 Term Ends: January 15, 2003

**CHARLES P. VALDES**  
 Vice President  
 Employee Member  
 (elected by all members)  
 Counsel, Department of  
 Transportation  
 Term Ends: January 15, 2002

**RONALD ALVARADO**  
 State Personnel Board Member  
 (designated by the State  
 Personnel Board)  
 Term Ends: Serves at the  
 pleasure of the State Personnel  
 Board





*(representative for Philip Angelides), Thomas J. Clark, William Dale Crist, Charles P. Valdes, Michael Flaherman, Kathleen Connell, Mike Quevedo Jr., and Ronald Alvarado.*

**PHILIP ANGELIDES**

State Treasurer  
Ex Officio Member

**ROBERT F. CARLSON**

Retired Member  
(elected by retirees)  
Retired—Chief Counsel,  
Department of Transportation  
Term Ends: January 15, 2004

**THOMAS J. CLARK**

Elected Official of Local  
Government<sup>1</sup>  
Former Councilman, City of  
Long Beach, Optometrist  
Term Ends: January 15, 1999

**KATHLEEN CONNELL**

State Controller  
Ex Officio Member

**ROB FECKNER**

Employee Member  
(elected by school members)  
Glazing Specialist  
Term Ends: January 15, 2003

**MICHAEL FLAHERMAN**

Employee Member  
(elected by public agency  
members)  
Economist, Bay Area  
Rapid Transit  
Term Ends: January 15, 2003

**MARTY MORGENSTERN**

Director, State Department  
of Personnel Administration  
Ex Officio Member

**MIKE QUEVEDO JR.**

Public Representative<sup>2</sup>  
Term Ends: January 15, 2000

**WILLIAM ROSENBERG**

Employee Member  
(elected by all members)  
Retired—Retirement  
Specialist, CalPERS  
Term Ends: January 15, 2002

**JOSEPH A. THOMAS**

Official of Life Insurer<sup>1</sup>  
Board of Directors,  
Best Life Assurance Company  
Term Ends: January 15, 2001

**Notes:**

<sup>1</sup> Governor appointee.

<sup>2</sup> Appointed jointly by the Speaker of the Assembly and the Senate Rules Committee.



CaIPERS BOARD COMMITTEES

In addition to their regular duties, Board Members also serve on permanent and ad hoc committees to review specific programs, projects, or issues and make recommendations to the Board. The following committees were active as of June 30, 1999.

**BENEFITS & PROGRAM  
ADMINISTRATION**

- Michael Flaherman, Chair
- Ronald Alvarado, Vice Chair
- Robert F. Carlson
- Kathleen Connell
- William D. Crist
- Marty Morgenstern
- William Rosenberg

This committee reviews all matters related to benefit program structure, actuarial studies and rate setting, retirement program policy, and administrative issues.

**PERFORMANCE & COMPENSATION**

- Thomas J. Clark, Chair
- Robert F. Carlson, Vice Chair
- William D. Crist
- Rob Feckner
- Mike Quevedo Jr.
- Joseph A. Thomas
- Charles P. Valdes

This committee studies and evaluates compensation mechanisms and criteria, develops policies and procedures, and makes recommendations to the Board concerning compensation of key personnel.

## FINANCE

**Robert F. Carlson, Chair**  
**Kathleen Connell, Vice Chair**  
 Philip Angelides  
 William D. Crist  
 Michael Flaherman  
 William Rosenberg  
 Charles P. Valdes

This committee provides financial oversight on all budget matters, evaluates funding alternatives, oversees preparation and recommends approval of the CalPERS budget, and oversees the CalPERS annual and periodic audits by both internal and external audit units.

## HEALTH BENEFITS

**Philip Angelides, Chair**  
**Thomas J. Clark, Vice Chair**  
 Ronald Alvarado  
 Kathleen Connell  
 Rob Feckner  
 Marty Morgenstern  
 Charles P. Valdes

This committee oversees the administration of the Public Employees' Medical & Hospital Care Act program and the Public Employees' Long-Term Care Act program.

## STRATEGIC PLANNING

**William Rosenberg, Chair**  
**Michael Flaherman, Vice Chair**  
 Philip Angelides  
 Thomas J. Clark  
 Kathleen Connell  
 Rob Feckner  
 Joseph A. Thomas

This committee oversees the strategic planning process, including selection of consultants, defining process direction, and monitoring implementation of the CalPERS Strategic Plan.

## INVESTMENTS

**Charles P. Valdes, Chair**  
**William D. Crist, Vice Chair**  
 Ronald Alvarado  
 Philip Angelides  
 Robert F. Carlson  
 Thomas J. Clark  
 Kathleen Connell  
 Rob Feckner  
 Michael Flaherman  
 Marty Morgenstern  
 Mike Quevedo Jr.  
 William Rosenberg  
 Joseph A. Thomas

This committee reviews investment transactions, the investment performance of both internal and external managers, and establishes investment policy and strategy.

## INVESTMENT POLICY SUBCOMMITTEE

**Charles P. Valdes, Chair**  
 Philip Angelides  
 Robert F. Carlson

This subcommittee conducts an inventory of all existing investment policies, procedures, and guidelines for review by the Investment Committee; and reviews and recommends revisions to these on a priority basis. It is also charged with developing a manual of policies, procedures, and guidelines, and a process for periodic revisions.

## R STREET SUBCOMMITTEE

**Charles P. Valdes, Chair**  
**Ron Alvarado, Vice Chair**  
 Robert F. Carlson  
 William D. Crist  
 Michael Flaherman

This subcommittee oversees the CalPERS headquarters expansion project, including the selection of contractors, approval of building designs, and approval of expenditures and budgets.

## CalPERS STAFF

### EXECUTIVE STAFF

**James E. Burton**  
Chief Executive Officer

**James H. Gomez**  
Deputy Executive Officer

**Robert Aguallo**  
Assistant Executive Officer  
Investment Office

**Vincent P. Brown**  
Assistant Executive Officer  
Financial & Administrative  
Services

**Allen D. Feezor**  
Assistant Executive Officer  
Health Benefit Services

[ **Margaret Stanley**  
Assistant Executive Officer  
Health Benefit Services  
thru May 1999 ]

**Kayla J. Gillan**  
General Counsel

**Barbara Hegdal**  
Assistant Executive Officer  
Member & Benefit Services

**Patricia K. Macht**  
Chief, Office of Public Affairs

**Sheryl Pressler**  
Chief Investment Officer  
Investment Office

**Ron Seeling**  
Chief Actuary  
Actuarial & Employer Services

**Robert D. Walton**  
Assistant Executive Officer  
Governmental Affairs,  
Planning & Research

*CalPERS Executive Staff from left to right: Robert Aguallo, Sheryl Pressler, Vincent Brown, Kayla Gillan,*



## DIVISIONS

**Denise Arend**  
Manager, Investment Operations

**Tom Britting**  
Chief, Office of Audit Services

**Jack Corrie**  
Chief, Information Technology Services

**Tom Fischer**  
Chief, Self-Funded Programs

**Tim Garza**  
Chief, Management Information Systems

**Pat Harris**  
Chief, Branch Development Center

**Linda Hoff**  
Chief, Office of Policy & Program Development

**Charles Hwu**  
Administrator, Data Administration

**Gary M. Jones**  
Chief, Member Services

**Michael W. Koester**  
Chief, Operations Support Services

**John Korach**  
Chief, Fiscal Services

**Jeff Lung**  
Information Security Officer,  
Office of Information Security

**Linda McAtee**  
Deputy General Counsel,  
Legal Office

**Ken Marzion**  
Chief, Actuarial & Employer Services

**Dave Mullins**  
Chief, Supplemental Savings Program

**Chris Nishioka**  
Chief, Benefit Services

**Michael Ogata**  
Chief, Planning & Research

**Tom Pettey**  
Chief, Human Resources

**Steve Phillips**  
Chief, Change Management

**Diana Proctor**  
Chief, Headquarters Expansion Project

**Fred Steinmetz**  
Chief, Health Benefit Services

**Nancy Welsh**  
Chief, Health Program Development

**Casey Young**  
Chief, Office of Governmental Affairs

## REGIONAL OFFICES

**Cory Antflick**  
Manager, San Bernardino

**Anita Commer**  
Manager, San Francisco

**Laura Duran**  
Manager, Orange County

**Elaine Edwards**  
Manager, San Diego

**Debra Gibson**  
Manager, Sacramento

**Edith Mercer**  
Manager, Los Angeles

**Elwin Nash**  
Manager, Mountain View

**Steve Pietrowski**  
Manager, Fresno

*James Gomez, James Burton, Ron Seeling, Barbara Hegdal, Robert Walton, Patricia Macht, and Allen Feezor.*



THE YEAR IN REVIEW





## PROCESSING RETIREMENTS

During fiscal year 1998-99, CalPERS continued our multi-year strategic emphasis on improvement and enhancement of customer service. This is being done by harnessing technology and simplifying our own internal business processing. By the year 2001, the results of these efforts will culminate in an improved way for our members to do business with us — with more options for transacting business, and faster, more efficient processes.

While we work behind the scenes to transform our own processes, we continue to meet customer demands, and this fiscal year was no exception. We issued more than 27,800 retirement estimates, and added 16,071 new retirees to our benefit roll. We paid out \$4.8 billion in benefits, with the average pensioner receiving \$1,272 monthly.

Our financial planning and retirement seminars continued to be enormously popular. During the year, staff conducted 247 financial planning seminars, serving 11,782 members.

These seminars and workshops help members set financial goals, figure out how to save more for retirement, and discuss budgeting, debt control, insurance, and Social Security benefits, as well as tax and estate planning. In fiscal year 1998-99, CalPERS began a new service — financial and estate planning seminars for retirees. The seminars were targeted in Sacramento and San Francisco and will be incorporated into our on-going seminar program next year. These seminars provide an overview of the benefits and programs of CalPERS, financial planning information, investment options, estate planning, lifestyle changes in retirement, and Social Security information.

## RESTRUCTURING FOR CUSTOMER SERVICE IMPROVEMENTS

To better meet the needs of CalPERS members, the Member Services Division restructured the way it conducts business. Under this reorganization, the eight CalPERS Regional Offices will be able to provide member estimates and provide a one-stop shopping approach.

How a business processes a customer request can involve a few simple steps or tens of separate processes — all to ensure that a customer gets the correct answer, or to ensure that the processing of a request is being conducted correctly. Add to that the fact that many processes at CalPERS have evolved over time, and it may be that our processes are not as efficient as they could be. That is why this fiscal year, CalPERS staff established a business process re-engineering project, to look for faster, less cumbersome ways of serving our customers. The project looked at 10 core business processes and identified opportunities for making these tasks more efficient. The improvements focus on streamlining operational procedures, eliminating redundant processes, and simplifying customer transactions.

In fiscal year 1998-99, CalPERS developed the SmartDesk computer application that moves us one step closer to a one-stop shopping environment. The new application allows staff from any program area to access customer data on their computer screen and better help customers with their questions. SmartDesk also allows staff to perform many routine customer transactions from a single system quickly, saving members' time and freeing up the phone system to handle more calls from other members.



MEMBER COMMUNICATIONS

Our staff handled more retirement and health program related telephone calls this past year than ever before. They were aided in this with the addition of more telephone information specialists and by taking advantage of advances in computer software which routes customer calls more expeditiously. An estimated 1.1 million telephone calls were answered through our telephone information centers.

The CalPERS web site, known as “CalPERS On-Line,” continued to grow in popularity. In September 1998, CalPERS added the Retirement Planning Calculator — a tool that calculates monthly retirement allowances and survivor benefits. Retirement estimates are based on any scenario the member wants to use. For example, a member can insert their date of birth, date of expected retirement, appropriate formula, years of service, and highest monthly salary for a 12- or 36-month period. Once they get these results, they can see how just changing the retirement date impacts future benefits. More than 250,000 on-line estimates have been completed since its launch.

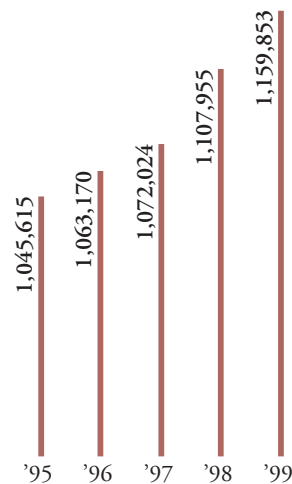
Also very popular this past year was our on-line Guide to Understanding Your CalPERS Annual Member Statement. Annual statements provide members with information on their contributions, years of service, applicable retirement formulas, and pre- and post-retirement death benefits.

This fiscal year, CalPERS launched a new communications tool — the CalPERS Member Network (CMN). CMN is a quarterly video news program that provides the latest information on CalPERS programs and services. Copies are provided to employee organization chapter presidents who show the 20-minute videos at local meetings. In addition, CMN was recently accepted onto cable channels across California, guaranteeing

broadcast to stations with one million viewers. CMN is chock full of retirement and health membership tips and interviews of policy makers and stakeholders on issues and programs affecting our members.

We made strides in other communication areas as well. Each year, CalPERS publishes a quarterly newsletter *PERSpective*. In fiscal year 1998-99, CalPERS conducted a survey of members to determine if they had regularly received this publication and if the information was useful. While a significant majority of members recalled receiving the newsletter, most could not recall how many times they received it. Members identified many ways in which the publication could be improved. This feedback was presented to the CalPERS Board of Administration, which in June voted to revamp the publication and guarantee that all members will receive it by having it mailed directly to their homes.

TOTAL CalPERS MEMBERSHIP  
FIVE-YEAR REVIEW



## BENEFIT EQUITY

Perhaps the biggest retirement initiative of the fiscal year began in the Fall of 1998 when CalPERS launched a drive to end benefit inequities among members through a plan to finance benefit enhancements from the extra earnings of CalPERS investments.

The inequities targeted by the Board included:

- a large financial disparity between retirement benefits provided to various State members, depending solely on whether they participated in First Tier or Second Tier plans;
- differences among cost-of-living adjustments for retirees, with some tied to differing benefit formulas and others having no such relationship;
- disadvantaged school members, whose retirements were based on the average of three years' pay rate, rather than the one-year final compensation period provided to all State members; and
- benefit formulas for most State and school members which had not been modified in nearly 30 years.

The Board resolution on benefit inequities called for the remedy of inadequate retirement benefits of more than 50,000 State workers currently in the Second Tier retirement plan. This would be achieved by offering those employees the First Tier formula. It also provided for the improvement of the benefit factors used to determine State and school member retirement benefits and a one-time cost-of-living adjustment for all retirees.

CalPERS secured a legislative author, Senator Deborah Ortiz (D-Sacramento), who chairs the Senate Public Employment & Retirement Committee. Senator John Burton, the President pro Tempore of the Senate agreed to be the principal co-author. The benefit

package, Senate Bill 400, was adopted by the Legislature and signed by Governor Gray Davis in September 1999.

The action followed months of analysis related to setting the employer contribution rates. Data presented to the Board indicated that the State enjoyed a windfall of \$755 million last fiscal year, as a result of excess CalPERS investment earnings and it was slated to get an additional \$300 million in fiscal year 1999-2000.

## MEETING THE NEEDS OF PART-TIME CLASSIFIED SCHOOL EMPLOYEES

In addition to ending inequities among existing CalPERS members, an effort began in fiscal year 1998-99 to help meet the retirement needs of part-time classified school employees. Under State law, those who work less than 20 hours a week were not eligible to participate in the CalPERS defined benefit plan. CalPERS coordinated a task force of employer and employee group representatives to develop a new plan for these workers.

The plan is a tax-qualified money purchase pension plan, as an alternative to participating in Social Security. Local school districts contribute at least 7.5 percent of each employee's compensation. Under the plan, the member has an immediate vested right to 100 percent of the value of the account. Participants can make pre-tax contributions and earnings accumulate tax-free until paid out in the form of a taxable distribution from the plan. If the member separates from service, either through leaving employment or retirement, they are entitled to the balance in the account.

**BOARD CREATES AN UMBRELLA  
PUBLIC AGENCY SUPPLEMENTAL  
PLAN ADMINISTRATION**

Providing special supplementary savings for retirement is a service that the CalPERS Board wants to offer our public agency employers. To this end, during the year the Board adopted a policy calling for establishment of supplemental retirement and savings plans, designed to complement our existing defined benefit plan and Social Security. The policy provides the framework for staff to offer these types of programs when called for and to develop strategic partners to administer them when employers request programs of this type.

The policy also placed existing offerings under one “umbrella” program area. This program includes a comprehensive education program to promote awareness of future retirement financial needs and the role of supplemental savings plans in augmenting retirement income. The umbrella program is called the CalPERS Supplemental Savings Program.

To this end, CalPERS retained State Street Global Advisors to partner with us on administration of all of our defined contribution and deferred compensation plans. The use of a single administrator enables us to provide state-of-the-art services from an experienced administrator and minimizes the impact of administrative fees on earnings allocated to the participants’ accounts.

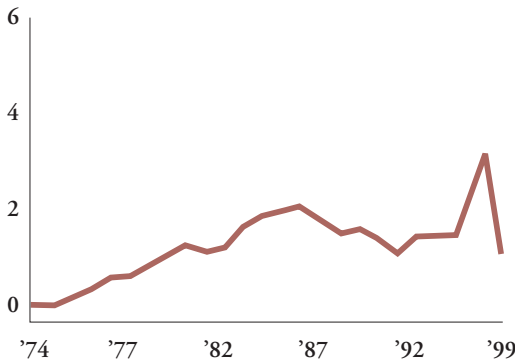
**THE 457 DEFERRED  
COMPENSATION PLAN**

One such program that benefits from this partnership is the CalPERS 457 Deferred Compensation Program. During 1998-99, the program had contracts with 239 public agencies and held \$108 million in assets. Investment choices in the public agency deferred compensation program have broadened with the addition of a passively managed small cap index fund, and fees have been slashed by 33 to 60 percent — substantially lower than competing private plans.

State employees enjoy benefits from a similar program called the Savings Plus Program administered by the Department of Personnel Administration (DPA). DPA contracts with CalPERS to manage three of the investment options in that program — the U.S. Treasury Short-Term and Intermediate-Term funds and

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**CaLPERS INCOME  
EMPLOYER CONTRIBUTIONS**  
**25-YEAR REVIEW**  
*(Dollars in Billions)*



the Standard and Poor (S&P) 500 Index fund. The U.S. Treasury Short-Term fund grew by 19 percent; the Intermediate-Term fund grew by 20.5 percent; and the S&P 500 Index fund posted gains of 100.7 percent.

### THE SUPPLEMENTAL CONTRIBUTIONS PROGRAM

State members can also save through the CalPERS Supplemental Contributions Program, which allows for the payment of additional contributions, that are invested in the CalPERS investment portfolio. Contributions receive the Fund's net earnings rate. Last fiscal year, the total assets of this program were \$18.3 million.

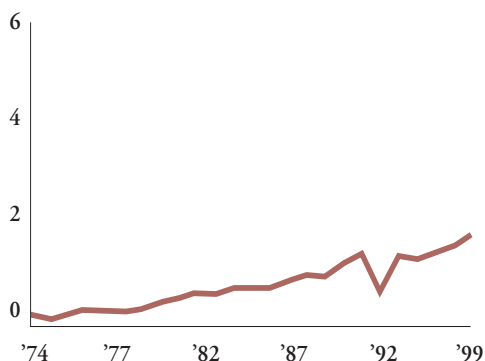
In an effort to improve service to our members, CalPERS sponsored legislation to make several beneficial changes to the program effective

January 1, 2000. A separate trust fund will be established in order to separate the Supplemental Contribution Program assets from those of the Public Employees' Retirement Fund (PERF) for investment purposes. As a separate trust, program assets will no longer be invested in the PERF, but in an investment portfolio that will be managed by the Investment Office and will provide returns closely approximating the PERF's performance. This change will facilitate separate accounting of the program's investment returns and expenses, allowing for more frequent valuations rather than the current annual valuation and earnings allocation. We anticipate that we will be able to support daily valuations later in 2000. The new legislation will further enhance the Supplemental Contribution Program by expanding the eligible participation base from that of current State employees to all CalPERS public agency members.

### CalPERS INCOME EMPLOYEE CONTRIBUTIONS

#### 25-YEAR REVIEW

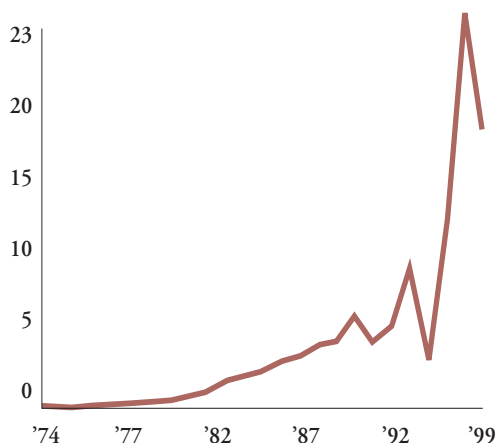
*(Dollars in Billions)*



### CalPERS INCOME INVESTMENTS

#### 25-YEAR REVIEW

*(Dollars in Billions)*



**MEMBER HOME LOAN PROGRAM**

In addition to the offerings for retirement, CalPERS also experienced a growth in member home loans. The CalPERS Member Home Loan Program provides real estate financing for members and is administered by more than 70 lending institutions with more than 950 branch locations. Since inception of the program, more than 54,000 loans valued at \$7.3 billion have been issued. In fiscal year 1998-99 more than 6,000 loans were issued totaling \$900 million.

Our program offers home loans which have many benefits over most conventional home loan programs, including up to 95 percent financing, a no cost 60-day interest rate lock-in feature, controlled closing fees, and some closing costs assistance. The program also allows some members to borrow up to 5 percent against their retirement contributions to make a down payment, providing 100 percent loans, if needed.

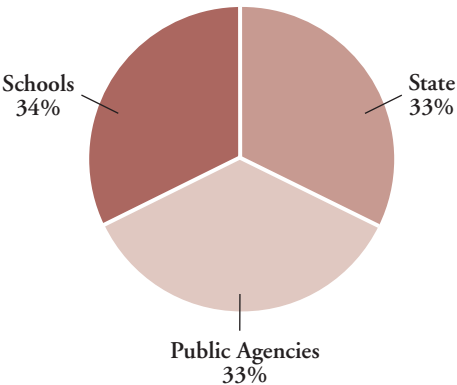
In fiscal year 1998-99 the Board added loans for manufactured homes to the program, and for the first time, allowed members who live out-of-state to be eligible for home loans. Member interest grew in using the Federal Housing Administration’s Fixed and Adjustable Rate Mortgage offerings. Under this special feature of the program, a member can borrow about 97 percent of the purchase price of the home. As of June 30, 1999, the FHA Program had 272 loans totaling \$32 million.

**ENHANCING EMPLOYER SERVICES WAS KEY IN 1998-99**

Employers continued to see significant reductions in their employer contribution rate in fiscal year 1998-99 — brought about as a direct result of CalPERS excellent investment returns, as well as low inflation and prospects for long-term wage growth. This lowers expenses to employers, and frees up funds for other critical public services.

Just how much employers have to pay for pensions is contained in employer valuations prepared by our Actuarial and Employer Services Division. During the year, more than 800 contract amendment valuations were completed; 306 benefit changes made; 248 contract amendments completed; and 13 new contracting agencies were added. But their work goes beyond that. For example, some 36,000 payroll reports were processed during the year. And the division trained more

**MEMBERSHIP BY EMPLOYER**



than 350 employers on membership, payroll, and health benefits information.

The Division utilizes cross-functional teams to handle employer needs. During the past year, services for employers which were previously handled by our Member Services Division were combined into these teams. This was our best opportunity to provide excellent customer service and resulted in streamlined processing due to the reduction of handoffs between two divisions, improved responsiveness to customer needs, and consistent communication and focused customer service.

Our Corporate Registration service significantly improved over the past year. The turn-around time for membership changes was reduced from one month to 2 to 3 days. Our Help Desk busy signals were eliminated, while the number of telephone calls increased 47 percent from last year. In addition, public agency and State membership transactions increased 50 percent and more than 300 percent, respectively.

Perhaps one of the more significant accomplishments was the partnership built with our public agencies on multiple projects throughout the year. Actuarial and Employer Services worked together with employers on both the Deferred Retirement Option Program and Menu Simplification/Pooling task forces. Staff held bi-monthly meetings with County Offices of Education and participated in PERS-PAC and League of California Cities meetings. CalPERS also worked with employers to establish customer service standards for contract amendments, as well as to reach agreement for the proper handling of membership exclusions.

## RETIREMENT PROGRAM HIGHLIGHTS FOR THE YEAR

- 816,512 active and inactive members
- 343,341 retirees, beneficiaries, and survivors
- 16,071 new retirees
- \$4.8 billion paid in benefits
- 2,443 contracting public agency employers (including school districts)





HEALTH AND LONG-TERM CARE REPORT

Economists in 1999 warned that the nation was likely to see renewed inflationary pressures in health care. Because CalPERS is one of the largest and earliest purchasers to negotiate with HMOs each year, much of the nation watched as CalPERS began negotiations.

Despite CalPERS efforts to stabilize premiums, many external factors — such as rising prescription drug costs, diminished Medicare reimbursements, and declining profits — have caused HMOs to raise rates. Many HMOs and physician groups across the U.S. were losing money, a consolidation in the health care industry was continuing, and HMOs were pulling out of many rural areas. Against this backdrop, CalPERS ended negotiations with an average rate increase of 9.7 percent for our Basic HMOs and obtained multi-year agreements with half of our HMOs — five out of 10 — helping to stabilize our costs over the long run.

It was also a trend-setting year in another respect. CalPERS became the first purchaser to negotiate a premium rate with Kaiser, the first to partner with them in auditing their ratesetting process, and the first to gain direct input into their business planning process.

A new low-priced plan, Universal Care, was added to the CalPERS health plan lineup. Also, two new patient rights were added to the benefit package — independent third-party review if coverage is denied on grounds that it is not medically appropriate, and assurance that legitimate emergency room fees will be covered. Now, CalPERS members will never have to wonder whether their health plan will cover the emergency room fee if, for example, they thought they were having a heart attack when in fact they suffered from indigestion.

1999 also saw a new administrator for the CalPERS self-funded plans, PERSCare and PERS Choice. After 10 years with Blue Shield, the administration of the plans was switched to

Blue Cross. Members of these plans now enjoy the Blue Cross state-of-the-art customer service system, high speed computerized claims processing, and quick pre-service authorizations. Blue Cross also set up a customer service unit devoted exclusively to CalPERS members.

Perhaps the most vexing problem of the year was how to solve the problem of provider service in rural areas, where doctors and hospitals are scarce and there isn't much competitive impetus for physicians to give discounts to HMOs. After witnessing several losses of HMOs serving rural areas, CalPERS began working with constituent groups to draft legislation that will provide a subsidy to keep health care financially viable for State employees who live in these areas. Subsidies were granted in the most severely affected regions.

Our annual member satisfaction survey provides members with information on how well each plan provides care and how other CalPERS members rate their plan. CalPERS closely monitors health plan overall satisfaction scores, as well as results for members requiring more services.

## QUALITY INITIATIVES

During the year, we continued our work with health plans and providers to develop strategies that will ensure responsiveness to customers. The CalPERS emphasis on quality was expressed this year by our decision to establish a separate division to focus on quality initiatives and program development. This division evaluates concepts such as risk adjustment, issues related to pricing of prescription drugs, exploration of ways to ensure appropriate referral to medical specialists, and partnerships with health plans on cardiovascular, asthma, and diabetes disease management.

CalPERS participated in a joint project with Health Net, several medical provider groups, and the nonprofit organization California Health Decisions. The project showed that access to specialists could be improved by better understanding how the HMO referral process works. One of the most surprising outcomes of the research was the discovery that even the physicians themselves often don't understand precisely how referrals work. Therefore, they aren't always able to fully explain the process to their patients. Researchers concluded that consumers are frustrated because they think the referral process takes too long, while physicians are frustrated because they feel their patients have unrealistic expectations as to whether a referral is really needed.

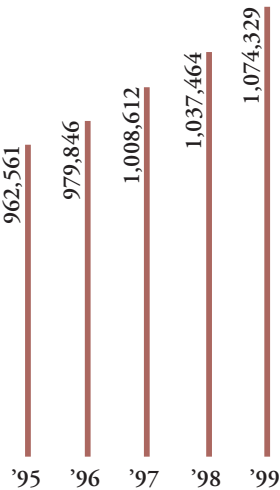
In addition, CalPERS teamed with Sacramento Healthcare Decisions to provide our members with a new booklet, *Finding Your Way*, which provides valuable information on end-of-life care decisions and more humane treatment of

dying patients. It is designed especially for the terminally ill, those who might face a terminal illness in the future, and those called upon to care for a terminally ill relative. Some 6,700 copies were distributed to CalPERS members during the year.

Assessment of the illness burden of populations across health plans and provider groups is an oft-discussed strategy for managing health care costs. CalPERS became a major player in this research area when it obtained a \$300,000 grant from the California Health Care Foundation to perform a risk assessment study to be conducted in collaboration with other major health care purchasers, health plans, and providers.

In August of 1998, CalPERS launched an Internet-based communications tool to streamline business between health plans, CalPERS, and our participating employers. It is called the CalPERS Health Partners Inquiry System. This computer system increases the speed with which employers and health plans can check on the enrollment status of a member, and frees up staff to handle special questions or requests. Security is ensured because the system is independent of our live databases and allows access only to those with a special identification number. Additionally, employers and health plans can only view information on their specific employees or plan members.

**TOTAL HEALTH PROGRAM  
MEMBERSHIP**  
**FIVE-YEAR REVIEW**



**SERVING EMPLOYERS**

More and more employers are discovering the advantage of having CalPERS manage their health care purchasing. We added 68 new public agencies during the fiscal year and more than 36,000 covered lives. CalPERS is processing health enrollments faster and errors in data entry have been reduced dramatically.

Retired members can now make some health changes over the telephone.

### THE CalPERS LONG-TERM CARE PROGRAM

The CalPERS Long-Term Care Program provides financial protection from the high cost of extended care following an illness. Six out of every 10 persons over the age of 65 will need such care — services that are not covered by regular health insurance or Medicare. During 1999, the 100,000<sup>th</sup> member was enrolled in the program, bringing total membership to more than 118,000. Our program is one of the largest and most respected long-term care plans in the nation, after just four years of operation. As of June 30, 1999, assets of the program exceeded \$386 million. Some \$6.8 million was paid in claims during the year.

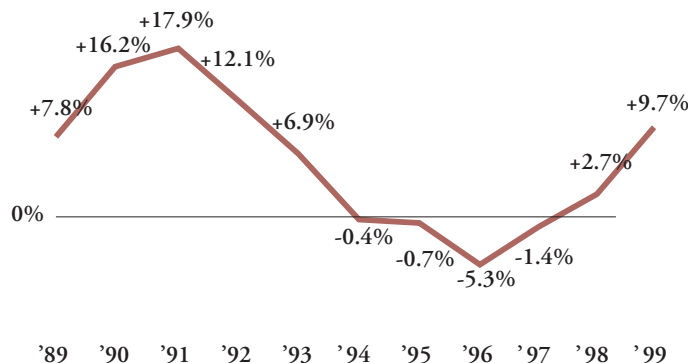
### HEALTH HIGHLIGHTS FOR THE YEAR

- 1,074,329 employees, retirees, and family member participants
- 62 percent are State members
- 38 percent are public agency members
- 1,244 participating public agencies
- \$1.6 billion paid in annual health premiums
- 121,000 enrollment documents processed during open enrollment

### HISTORY OF BASIC HMO PREMIUM AVERAGES

PERCENT DECREASE OR INCREASE.

BASED ON WEIGHTED AVERAGE OF ALL CalPERS HMOS.



INVESTMENTS



## INVESTMENTS — ANOTHER BANNER YEAR

The CalPERS investment portfolio continued to post healthy gains during the 1998-99 fiscal year. The Fund's total investment portfolio market value at June 30, 1999 was \$159.4 billion, growing by approximately \$16.1 billion during the year, after contributions and benefit payments. The System earned a 12.5 percent return on investments, marking the fifth straight year of double digit returns since the CalPERS Board voted to invest more of our assets in U.S. and international equity markets. This performance was exceptional given the complexities of the global markets.

Our strong investment performance was led by gains in equity investments. In total, approximately two-thirds of the System's assets — or 65 percent of the Fund — were invested in publicly-traded equities. CalPERS U.S. stocks returned 20.7 percent, beating the 20.3 percent return earned by its benchmark, the Wilshire 2500. International stocks returned 8.7 percent, compared to a benchmark return of 8.2 percent.

Diversification in other asset classes helped to preserve gains in the investment portfolio and served as an insurance policy against dips in the equity market. Several of the asset classes posted healthy returns.

CalPERS limited partnership investments earned more than 13.5 percent, while the private equity investments gained 17 percent. Total fixed income investments earned a 1.8 percent return versus the benchmark of 1.9 percent. Our internally managed U.S. fixed

income investments also beat their benchmark during the period when the U.S. bond markets fell victim to rising domestic interest rates. CalPERS U.S. fixed income investments earned a 1.6 percent return outpacing the Salomon Brothers Large Pension Fund Index return of 1.3 percent, while our international bonds gained 2.6 percent versus the Salomon Brothers Non-U.S. Government Index of 4.9 percent.

## CORPORATE GOVERNANCE

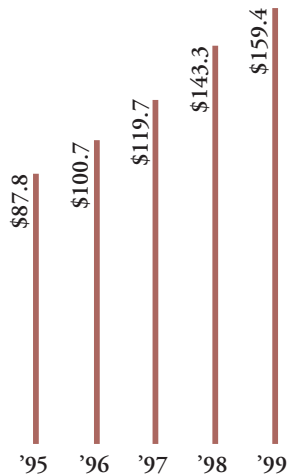
The year also marked the 12<sup>th</sup> anniversary of our U.S. and international corporate governance program. During the proxy season, we issued our "Focus List" of Corporate America's poorest performers. The companies included Tyson Foods, Circus Circus, Cummins Engine, Pacific Century Financial, Pioneer Resources, Sierra Health, St. Jude Medical, Mallinckrodt, and National Semiconductor. CalPERS pushed a variety of corporate governance improvements at these companies in an effort to generate better returns and long-term growth. Several companies escaped greater pressure by agreeing to institute several shareowner protective changes, including such things as electing independent directors and audit committees, eliminating poison pills, and adopting the CalPERS definition of an independent director.



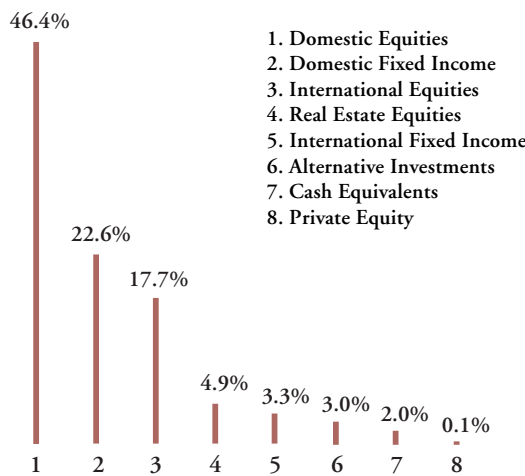
To improve the lines of communication between investors and corporations, we also launched a new web site dedicated to advancing good corporate governance in the world’s financial markets. The new site — CalPERS Shareowner Forum — provides breaking news on our corporate governance activities and proxy voting decisions in time for company annual meetings. The site also provides information on shareholder litigation activities, criteria for selecting our annual list of focus companies, full text of our U.S. and international corporate governance principles, and a library of more than 14,000 abstracts of interdisciplinary studies, essays, reports, and papers on corporate governance global issues, trends, and views. The CalPERS Shareowner Forum is a one-stop shop for corporate governance knowledge and brings our program into the instant access age.

On the international front, CalPERS joined forces with Hermes, the investment manager for two major pension systems in the United Kingdom. The transcontinental corporate governance alliance provides that CalPERS and Hermes each endorse the other’s home market corporate governance proxy voting policies and generally vote their proxies in accordance with those policies. Additionally, we have vowed to work cooperatively and represent each other in our respective markets, including at annual shareholder meetings. The combined power of CalPERS and Hermes is expected to mean greater shareowner pressure on companies in the U.S. and the United Kingdom.

**GROWTH OF INVESTMENT  
PORTFOLIO — MARKET VALUE  
FIVE-YEAR REVIEW**  
*(Dollars in Billions)*



**INVESTMENT MIX  
BY ASSET CLASS**



Recognizing that the Year 2000 computer compliance issue could impact the world's markets, CalPERS wrote to more than 1,600 companies in our equity portfolio, calling on them to fulfill their obligations to investors and comply with the Year 2000 disclosure requirements adopted by the U.S. Securities and Exchange Commission. We went one step further in the international arena, issuing a survey to some 2,600 non-U.S. corporations to determine their state of readiness. Corporations were asked to provide information on compliance certificates, the status of renovating and testing their mission critical systems, and contingency plans.

### LOW COST INVESTOR

CalPERS continues to be a value-added leader in managing our investment assets at low cost. According to a study issued by Cost Effectiveness Measures, Inc., our investment decisions earned an extra \$2 billion over and above projected returns. Our performance exceeded 91 percent of other large public and private pension funds, and did so at a lower cost. While CalPERS spent \$124 million for consultants, internal management, and external managers, it amounted to only one-tenth of one percent of the Fund's value. Our costs were far less than other large multi-billion-dollar pension funds, whose median costs were nearly 48 percent higher.

The study concluded that our investment expenses were low because we continued to manage the bulk of our equity investments passively and chose to manage these assets, and our fixed income portfolio, internally by staff. Even CalPERS expenses in typically high cost areas such as real estate and alternative investments were well below our peers. The lowest comparative cost was consulting fees.

### INVESTMENT POLICY & STRATEGY

The CalPERS Board has investment authority and sole responsibility for the management of assets. They decide how the assets are allocated and make the investment decisions that staff implement on a daily basis. Every month, the Board receives reports on performance, transactions, manager reviews, cash flow estimates, activity deal flow, and partnership and manager selections in order to monitor asset classes. Once a year, the Board participates in an asset liability management workshop to review the asset class targets, and meets in a special workshop to analyze factors important in determining the appropriate asset allocation. The health of global financial markets, future liabilities of CalPERS, and expected future contributions are also analyzed.

CalPERS asset allocation is one of the most important policies and investment strategies set by the Board. It is essentially the starting point — and the most important component — for CalPERS to achieve successful returns. In the long run, it is the way we diversify stocks, bonds, cash, and other investments that is largely responsible for strong returns.

There are two types of asset allocations, strategic and tactical. Strategic asset allocation is the basis for long-term asset allocation targets in each asset class. Ranges are included in the policy to provide the needed flexibility to take advantage of market opportunities. Information is received from staff, research services, and money managers. This forms the tactical asset allocation which allows shifts between classes to take advantage of emerging or rapidly changing market opportunities.

## INVESTMENTS

In addition to the asset allocation policy, the Board established the following investment objectives for the portfolio.

### *Inflation*

Achieve a total portfolio return of 4 percent in excess of the U.S. Consumer Price Index.

### *Actuarial*

Achieve a total portfolio return above the assumed actuarial interest rate, currently 8.25 percent for the period July 1, 1998 through June 30, 1999.

### *Performance*

1. For the internal equity index portfolio, achieve a return equal to the Wilshire 2500 Index, plus or minus 50 basis points.
2. For externally managed assets, meet specific performance objectives related to their investment style, which are outlined in their contract.
3. For internal domestic fixed-income instruments, achieve a return in excess of the Salomon Brothers Large Pension Fund Index.
4. For equity real estate, achieve at least a 5 percent real rate of return.
5. For alternative and private equity investments, achieve an annual hurdle rate of 15 percent.

## GLOBAL PUBLIC MARKETS

Public market investments represent the largest portion of our investment portfolio. At the end of 1998-99, more than \$107 billion was invested in the U.S. and international equity markets and \$41.3 billion was invested in domestic and international fixed income.

Approximately \$56.3 billion of our domestic equity assets are passively managed internally and \$1.5 billion are managed by one external small capitalization passive manager, while the remaining \$8.8 billion are actively managed by external fund managers. The System's \$35.8 billion domestic fixed income portfolio is managed internally, while all international equity and fixed income investments, valued at \$33.5 billion, are managed externally, using 13 investment managers.

During the year, the CalPERS Board approved a plan to actively manage up to \$2 billion of domestic stock investments in-house. CalPERS believes the benefits of internal active management, including increased diversification, lower cost, and flexible investment decisions will add value to the Fund. CalPERS began to fund several different strategies, such as enhanced index funds and synthetic index funds, in amounts ranging from \$200 million to \$500 million. Each strategy carries with it a unique portfolio construction and trading procedure.

CalPERS also embarked on a new innovative manager development program that focuses on the development of new and emerging money managers. The goal of the program is to achieve superior investment returns while providing opportunities to new and emerging money managers that typically don't have the stature, investment performance track record, business expertise, and marketing clout to compete against larger, more established firms. We committed almost \$4 billion to the new program and selected two California-based firms to help implement it.

Under the program, CalPERS would provide assets for the new firms to invest and may take an equity position in the firms to assist participating firms to grow. CalPERS and our two partners also vowed to provide emerging firms with assistance and support in business management, accounting, technology infrastructure, marketing, and other services that are needed to succeed. It is expected that as the firms grow and mature, CalPERS will realize profits from our equity positions when a firm goes public, or is bought out by larger established firms.

#### **ALTERNATIVE INVESTMENT MANAGEMENT (AIM) PROGRAM**

CalPERS commitments to partnership investment has increased over the past three years, resulting in a majority of the portfolio being in the early stage of its investment life. At the end of the fiscal year, CalPERS had committed more than \$8.4 billion to 119 partnership investments, which posted a 21.2 percent return.

Corporate restructuring and expansion capital strategies make up the largest percentage of commitments in the AIM program, representing 56 percent or \$5.5 billion. This is followed by venture capital, which captured more than \$1 billion of the System's dollars.

We also continued to reserve a portion of our portfolio to direct investments. Market conditions required us to be more selective and efficient, and direct investments provided a foundation to find creative ways to put capital to work in the private equity market. We committed approximately \$1.8 billion to 13 independently sourced direct investments, co-investments, and investment vehicles. These earned a 15.5 percent return for the year.

Additionally, we continued to sharpen our focus on value-added investments that build businesses by targeting California investments that capitalize on the State's strong economy and innovative technology advancements. In October 1998, we implemented a \$350 million California Emerging Ventures Program — a venture capital investment vehicle that will invest heavily in California. We believe the program allows us to take advantage of the pace of technological change in California and help establish long-term relationships in the venture capital arena. At the end of the year, the program had successfully invested \$15.5 million, which increased in value to more than \$16 million — a 26 percent return on investments.

Internationally, we sought out alternative investments that captured opportunities in recovering Asian markets. We invested \$175 million in two funds that make investments through acquisitions, spin-offs, restructuring, and in corporations emerging from bankruptcies.

REAL ESTATE

Valuable opportunities in the real estate market were abundant during the year. Our total real estate investment portfolio market value was more than \$7.8 billion, growing \$1.6 billion from last year. The majority of the portfolio included more than \$5.6 billion in apartment, retail, industrial, and office investments.

The dramatic growth in the System’s real estate portfolio occurred during the last few quarters of the fiscal year when REITS were sidelined with low stock prices. CalPERS snapped up more than \$1 billion in core real estate assets as REITS began to downsize and prune some of their assets. Nearly half — or \$518 million — of the properties purchased were California apartment, office, retail, and industrial buildings. More than 40 percent of the properties purchased included grocery-anchored retail centers and industrial buildings, properties that are more resistant to downturns in the market.

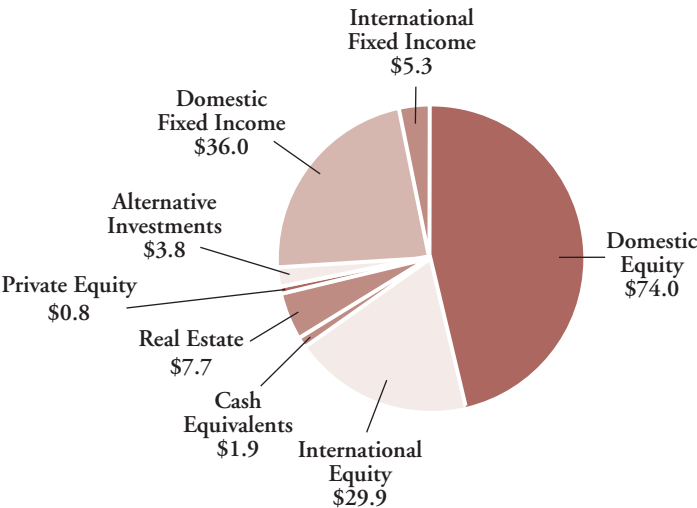
The heavy acquisition activity followed on the heels of a two-year review of CalPERS real estate. The review sealed the selection and retention of core real estate advisors to manage apartment, office, industrial, and retail properties. Each firm co-invests significant equity with CalPERS and operates under a philosophy that is consistent with our investment objectives. The result is a better, more effective alignment of interests between management and CalPERS, and an environment where responsibility and accountability are crystal clear.

Additionally, we began to develop and implement strategies for the remaining \$2.2 billion in specialized real estate investments such as timber, housing, land, and other specialized programs. We approved a new strategic plan for timber investments and conducted a nationwide search for new investment firms to manage our \$1.2 billion in

INVESTMENT PORTFOLIO — MARKET VALUE

AS OF JUNE 30, 1999 — \$159.4 BILLION

(Dollars in Billions)



timberland. The plan also called for CalPERS to explore timberland investments outside the United States.

## CALIFORNIA INVESTMENTS

CalPERS pumps almost \$18 billion into California's economy through our equity investment, real estate holdings, home loan program, and other economic activity, becoming a critical part of the economic fabric of the State. From the San Francisco Bay Area, to the Central Coast, to the greater Los Angeles region, our investments help build houses, finance homes, and provide the capital that supports a strong economy.

We invested more than \$10 billion in corporations who make their home in California or have operations in our State. Our real estate holdings and mortgages finance \$2.7 billion worth of single family homes and general real estate holdings, while our fixed income assets, largely held in government and corporate bonds, amount to more than \$4.3 billion.

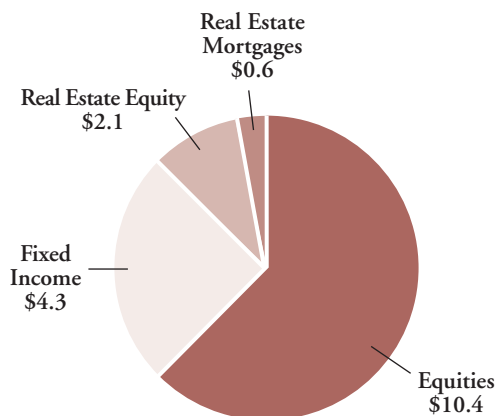
Fulfilling our commitment to seek out investments that strengthen California's economy, the Board invested approximately \$340 million in California community shopping centers in San Francisco, Los Angeles, San Diego, and Santa Barbara. For our members and retirees, it was a good investment. For California, it served as a capital infusion into community retail properties and the economy.

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## CalPERS CALIFORNIA INVESTMENTS

AS OF JUNE 30, 1999 — \$17.4 BILLION

*(Dollars in Billions)*







## LEGISLATIVE HIGHLIGHTS

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## STATE UPDATE

As part of its regular duties, the CalPERS Board of Administration develops legislative positions and proposals that serve the best interest of our members and employers. The Board uses its own Legislative Policy Standards as a guide in formulating positions.

The Board supports or sponsors legislation that actively seeks to remedy inequities in benefits; corrects deficiencies in program design; adds protection to the trust; provides necessary flexibility in program administration; offers program changes developed through collaboration with our stakeholders; provides new benefit options that support consolidation of contract options or “pooling”; or provides benefit improvements to excluded employees and retirees that recognize the unique needs of these groups and are consistent with benefits provided to represented employees.

The Board will remain neutral or take no position on legislation that changes benefits which are appropriately subject to collective bargaining; does not significantly impact benefits or System administration, or those that have conflicting policy implications; mandates changes already in our health program; or makes requirements to purchasers of health care.

The legislative standards also guide the Board in determining when it may be appropriate to oppose legislation. Situations of this type may include legislation that threatens the security of the trust fund; results in an unfunded liability or does not provide proper actuarial funding; deprives members of vested benefits; restricts investment authority; endangers the tax-exempt status of our programs; limits the Board’s constitutional administrative authority; creates subcategories within member classifications; threatens the integrity of the health purchasing pool; mandates benefits to the health program; or results in adverse selection between health plans.

## *The 1998-99 Legislative Year*

The following is a brief summary of some of the CalPERS-related legislation that was enacted during the first year of the 1999-2000 Session of the California Legislature.

### **AB 26, Chapter 588 (Migden)**

Provides that upon election by the employer, “eligible family members” in the CalPERS Health Program include domestic partner coverage, during the lifetime of the eligible member.

### **AB 88, Chapter 534 (Thomson)**

Requires health plans to cover expanded mental health benefits by removing current benefit limits.

### **AB 99, Chapter 801 (Cedillo)**

Establishes a new optional pre-retirement death benefit (Fifth Level) in the 1959 Survivor Benefit Program for contracting local agencies, which is indexed to avoid erosion due to inflation for members not covered by Social Security.

### **AB 232, Chapter 800 (Alquist)**

Eliminates the reduction or elimination of survivor continuance allowances and pre-retirement death benefits to surviving spouses of local members upon remarriage, and restores the monthly allowances that have been eliminated due to remarriage of survivors.

### **AB 596, Chapter 834 (Honda)**

Allows eligible members to elect to purchase service credit in CalPERS for up to three years as a volunteer in the Peace Corps or America Corps: VISTA.

## HIGHLIGHTS

**AB 817, Chapter 897 (Assembly Public Employees, Retirement & Social Security Committee)**

Provides that the State contribution rate for the Legislators' Retirement System shall be established annually in the same manner as done for the Public Employees' Retirement System. The CalPERS Board would be authorized to reduce the statutory rate paid by members for any year in which the State contribution rate is zero.

**SB 397, Chapter 684 (Ortiz)**

Restores the authority of public agencies to contract with CalPERS for two years of additional service credit for their employees, and requires employers to provide for public disclosure prior to amending their contract.

**SB 400, Chapter 555 (Ortiz)**

Provides one-year final compensation to school members and establishes the improved State Miscellaneous formula as the primary formula for State employees hired on or after January 1, 2000. Allows current Second Tier members to elect First Tier for future service, and to purchase past Second Tier service under First Tier. Provides a 2% at 55 formula to State and school members, 3% at 50 for State Patrol, 3% at 55 for State Peace Officers/Firefighters, and 2.5% at 55 for State Safety members. Provides an ad hoc increase of up to 6 percent to current State and school retirees. Provides State and school members not covered by Social Security a new, higher pre-retirement death benefit.

**SB 514, Chapter 743 (Chesbro)**

Establishes the Rural Health Care Equity Trust Fund to be administered by the Department of Personnel Administration. The fund will subsidize health care costs incurred by State employees and retirees in rural areas where there is no access to an HMO. Specifies the methods for determining amounts to be contributed for represented, excluded, and retired State employees. Provisions sunset December 31, 2004.

**SB 800, Chapter 633 (Dunn)**

Increases the maximum retirement benefit cap from 75 percent to 85 percent of final compensation for local safety members who retire on or after January 1, 2000. Does not require local agency employers to amend their contracts with CalPERS for this purpose.

**SB 976, Chapter 671 (Perata)**

Enables the surviving spouse of a judge who was retired for disability under the Judges' Retirement System (JRS) II to receive an allowance equal to 50 percent of the deceased judge's allowance. Permits active judges under JRS and JRS II to make an irrevocable election to provide an Option 2 Benefit to a survivor in the event of the judge's pre-retirement death. Permits judges on disability retirement to hold public office without loss of pension benefits.

**SB 1073, Chapter 310 (Senate Public Employment & Retirement Committee)**

Provides that State employers pay a temporary disability allowance to an employee placed on involuntary leave status pending an employer-requested disability retirement determination.

## FEDERAL UPDATE

Our federal relations program continued to ensure the interests of the System, our members, and employers were safeguarded in the overall federal policy-making process.

Social Security continued to be a top priority in Washington, D.C. However, the support for mandatory Social Security coverage of all newly hired State and local government employees was significantly curtailed. This success was due in large part to efforts by a coalition of public sector groups, including CalPERS.

CalPERS Chief Executive Officer, James E. Burton, led a delegation of California public employers and employees to meet top White House officials on this issue. President Clinton invited Burton to be a delegate to the top-level White House conference on Social Security. And following that conference, when the President offered his Social Security plan it did not include mandatory coverage.

Congress is advancing pension portability legislation that contains key provisions to assist public employees. This legislation would enhance pension portability in public sector defined benefit plans and allow workers to take their deferred compensation and defined contribution savings with them when they change jobs. It would also provide more extensive portability between all defined contribution and deferred compensation plans.

Support is building in Congress to improve upon long-term care insurance tax incentives enacted in 1996. One proposal would make long-term care insurance expenses fully deductible by 2007, creating an above-the-line tax deduction for those purchasing qualified policies. In effect, the cost of long-term care insurance would be fully deductible from taxable income without itemizing.

The growing awareness of the rising costs for prescription drugs, especially for the elderly, has gotten the attention of Congress and the White House. The President and top lawmakers from both parties are working to develop a proposal to help pay for prescription drug coverage for Medicare beneficiaries that would not bankrupt the already financially troubled Medicare system. When an agreement is reached on Medicare reform it is likely to include some level of financial assistance to make drugs more affordable.

MOVING INTO THE NEW MILLENNIUM



## MANAGING BY HARNESSING TECHNOLOGY

Technology provides many ways to solve business problems and help provide world class service to our customers. Within CalPERS this past year, much progress was made toward replacing older systems, updating others, and creating a networked environment that makes it easy and efficient to provide customer service. Our automated health member transaction system provides on-line verification of data by employers, CalPERS, and our HMOs. Our SmartDesk system allows for simple changes to be made on all CalPERS systems in a faster time.

We also automated our human resource and financial accounting systems, and we created a state-of-the-art check and balance system for our investments. Known as the Investment Accounting Reconciliation System, this new system enables CalPERS to reconcile our cash and position holdings with the custodian bank. Today, it reconciles transactions in the fixed income and equity portions of our assets. In two years, it will expand to include real estate, commercial mortgages, external managers, and alternative investments in a “data mart” that will make information access easier.

Transitioning CalPERS to the most outstanding customer service environment possible is a significant challenge. The logic used in our computer systems has to be changed to reflect the better ways of solving our business problems. Systems are and will be less complex as many of our business rules which no longer make sense are changed.

CalPERS is committed to using Internet technology to enhance customer service and self service. The on-line CalPERS Retirement Planning Calculator is promise of things to come. As new technologies emerge, CalPERS will find ways to apply them to better serve our members and employers.

Information security is also top priority for CalPERS. To this end, CalPERS has established an information security policy, continually educates staff on issues related to security, and monitors developments in the field, which has come into its own with the fast-paced changes in information technology.

While the information security field is evolving, CalPERS as well as all businesses are from time to time vulnerable to computer viruses, such as the Melissa virus and its variants in March 1999. While the Melissa virus didn’t interfere with CalPERS business, it was definitely a nuisance. It took about 24 hours to rid our systems of the virus — and it gave us a glimpse of what could happen if we don’t plan ahead.

## Y2K READINESS

The CalPERS three-year effort to make sure Year 2000 issues do not disrupt essential services came to a successful conclusion at the end of fiscal year 1998-99. After planning, assessing, modifying, and replacing outdated equipment, all mission critical information systems at CalPERS are ready for the Year 2000. We completed an ambitious program of assurance on all CalPERS mainframe systems, applications, servers, personal computers, and investment-related systems, and all are certified to be compliant. We have also implemented a comprehensive business enterprise program, designed to minimize risks to our business operations by making sure our service providers and contractors are also Y2K compliant.

Yet, CalPERS was preparing for the unexpected. As an extra layer of precaution, CalPERS embarked on phase two of the Y2K compliance project — called operational readiness. This involves creating contingency and operational readiness plans. Key personnel will staff an event management center during



the hours before and after December 31. We will monitor the year end as it moves across the globe and then verify that key building systems and computers are operational. Once all systems are brought back into operation, the “integrity” of our data will be verified to ensure our Y2K mitigation efforts were successful.

### MANAGING DAY-TO-DAY

To provide top quality service to customers, the CalPERS Board recognized the importance of being a “destination” employer — by attracting and retaining top performers. To this end, CalPERS staff recruited and filled more than 247 positions, tested more than 2,000 applicants, developed innovative training and leadership programs for our managers, and established an award-winning employee recognition program.

The Human Resources Division re-engineered our existing position management and recruitment business processes, utilizing the PeopleSoft software system. CalPERS is one of the first State agencies to successfully develop and deploy the PeopleSoft human resource system enterprise-wide.

CalPERS also created an employee development resource guide, an innovative instrument designed to be a comprehensive listing of the skills and knowledge needed by staff to carry out the business of CalPERS. This guide provides detailed lists of the knowledge, skills, and individual traits necessary for each job classification within CalPERS. It is the foundation for developing a training plan that addresses the knowledge and skills needed to achieve our strategic goals and objectives.

It is often said that there are no born leaders, but leaders are developed. To ensure that CalPERS — from our executive staff to front-

line supervisors — is providing the best leadership possible, CalPERS sponsored training forums for 200 executives, senior managers, and operations supervisors. Through a series of exercises and discussions, staff were exposed to principles of teamwork, problem solving, and communication. The training project worked in tandem with a 360-degree multi-level feedback program, which provides managers with views of subordinates, peers, and superiors. This feedback becomes the focus for growth, and is accompanied by a four- to six-month re-evaluation. All leadership groups showed positive growth in their skills. In addition, more than 900 CalPERS employees were trained in the CalPERS strategic goals, mission, and objectives that focused on our business services, teamwork, and change management.

The need for effective communication among and between employees and units was emphasized with the development of communication plans for all CalPERS divisions during the year. These plans help staff improve our face-to-face communication and our understanding of business programs and processes, so we are better able to educate and transact business with our customers.

The System also created an internal web site “The Insider” to help streamline communication and facilitate the transfer of and access to information. In its first nine months of operation, more than 3,000 documents were placed on the desktop of every employee, enhancing their ability to have information at their fingertips when customers call.

## CONTINUING GROWTH

The growth of CalPERS over the last 10 years has been staggering. Unfortunately, CalPERS has outgrown our existing space in the Lincoln Plaza building and has temporarily moved portions of our services to other locations. In August 1999, the Sacramento Regional Office and several other divisions moved to leased space at Gateway Oaks, off of the I-5 corridor in Sacramento. For several years, our Central Records Unit has been located off site as well.

CalPERS recently learned of land available for sale across the street from our present offices. After conducting a survey of future space needs, CalPERS purchased the two-square-block area adjacent to our headquarters building for expansion. The acquisition, known as the "CalPERS Headquarters Expansion Project" will be developed for approximately 540,000 square feet of office and retail space and 180,000 square feet of residential space. Hines, a prominent global real estate development firm, will serve as developer of the project. Hines will oversee and manage all aspects of the project including master planning, programming, design, and construction. Pickard Chilton of New Haven, Connecticut was selected as the external design architect. IA, Inc. of San Francisco will serve as interior architect and EIP of Sacramento will provide environmental review and consultation. Construction of the building is scheduled to be completed in 2003.

## AWARDING EXCELLENCE

The achievements of our workforce can be demonstrated through the variety of awards CalPERS staff have received from professional organizations.

The System was honored for our nationwide leadership in the health arena. The Foundation for Accountability, a consortium of consumer organizations and health care purchasers representing 80 million Americans, presented its annual award to CalPERS and four other organizations and individuals in the health care industry. The award cited CalPERS leadership in publishing one of the nation's most highly regarded health plan enrollment guides, one of the first to include ratings of both HMO and PPO plans using performance measures.

Our Chief Executive Officer, James E. Burton, was selected as Public Administrator of the Year by the American Society of Public Administration's Sacramento chapter. The Society honors individuals who have demonstrated significant achievements in public management and public service. The award cited his leadership at CalPERS over the past five years and his initiation of an ambitious strategic plan that includes the overhaul of information technology systems and simplification and re-engineering of our customer service and business processes. He was chosen from more than 200 public administrators nominated for the award.

Burton was also named as one of the Top 20 Managers of the Year by *Sacramento Business Magazine*. He was particularly noted for treating the Year 2000 computer date problem as a business opportunity to upgrade aging mainframe computer systems.

And the CalPERS Chief Investment Officer, Sheryl Pressler, was honored by more than 200 of her industry peers at the 1999 Institute for Fiduciary Education "Market Makers" Conference. She was presented with the award that recognizes special contributions to the pension and investment community. Since she joined CalPERS, the average annual

investments returns have been more than 14 percent, a ranking better than most pension funds with assets of more than \$1 billion. She was also credited with leading a group of more than a dozen large pension funds on a campaign to examine ways to obtain better terms and conditions in private equity deals. Her efforts resulted in two industry studies that call for general partners to disclose performance, profitability, and cost information needed for pension funds to make prudent investment decisions.

The Institute of Internal Audits bestowed two awards to Tom Britting, the Chief of the CalPERS Office of Audit Services — the Lawrence B. Sawyer Award for advancing the internal auditing profession through growth in the certification of our internal auditors, and the Commitment to Quality Award for quality of service and professional outreach. The Office of Audit Services provides both audit and consulting services to CalPERS. They evaluate risk mitigation strategies and internal controls, and they provide front-end consulting in order to prevent problems.

And CalPERS received some 16 awards from various professional associations for the quality of our member publications, brochures, videos, and other collateral materials.

### THE FISCAL YEAR AHEAD

For the first time in almost 30 years, CalPERS members will receive enhanced retirement benefits, resulting from legislation signed into law in September 1999. As the summer ended and Fall 1999 began, our attention turned toward ensuring that all the benefit changes signed by the Governor were implemented as expeditiously as possible. For example, all State Second Tier members were scheduled to receive a special packet of information that will provide

personalized cost and payment options for service credit purchases associated with First Tier membership. The cost-of-living increase for State and school retirees signed by the Governor will take several months to process, but all eligible members were slated to see the change in their April 1, 2000 retirement benefit payment.

Members are likely to see tremendous improvement in the amount of time it takes for a variety of CalPERS services — from getting a simple question answered at our telephone information centers to requests for retirement estimates or service credit purchase information — as we move forward with our plans for improved customer responsiveness.

In the investment arena, we will be continuing to refine our programs and strategies for the long-term benefit of the Fund. We will be conducting a thorough review and developing a new strategy for our international equity and fixed income programs, and we will begin to develop new ways to place more money in venture capital investments. We are also completing a new investments trading room with the technology critical to our operations and success.

Serving our members is our number one priority. All of our day-to-day work is critical to so many people's lives. Our efforts in developing new computer systems, new training, enhancing customer service, and improving communication are aimed at helping us continue to meet that goal.





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